RBI POLICY: STANDING AGAINST THE WIND

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The MPC statements today began on an audacious footing; invoking Kautilya's fabled time trove *Arthashastra* to justify the quest of stability as a righteous vector of equitable wealth augmentation for one and all and the centrality of regulatory endeavors to such overarching confluence of means/ends.

As widely expected, MPC decided to keep repo rate at 6.50%. It also decided to remain focused on withdrawal of accommodation to ensure that inflation progressively aligns with the target, while supporting growth, though not unanimously. One of the members expressed reservations on withdrawal of accommodation.

RBI retained its inflation projection for FY24 at 5.40% with Q2 at 6.4% (earlier: 6.2%), Q3 at 5.6% (earlier: 5.7%), and Q4 at 5.2% (earlier: 5.2%). A slight downward revision for Q3 projection is on the back of vegetable price correction and the recent reduction in LPG prices. The future trajectory will be conditioned by a number of factors like lower area sown under pulses, dip in reservoir levels, El Niño conditions and volatile global energy and food prices. We believe that inflation is less likely to breach the 6% mark in coming months and will remain range bound (5-6%).

RBI has retained its real GDP projection at 6.50% for FY24 with Q2 at 6.5%, Q3 at 6.0% and Q4 at 5.7%. All estimates are same as provided in the last policy. Domestic macro conditions are expected to benefit from the sustained buoyancy in services, revival in rural & urban demand (due to upcoming festive season), consumer and business optimism, the government's thrust on capex, and healthy balance sheets of banks and corporates. However, headwinds from global factors like geopolitical tensions, volatile financial markets and energy prices, and climate shocks pose risks to the domestic growth outlook.

Liquidity turned into deficit mode in second half of September owing to increase in Government surplus cash balances following advance tax and GST outflows, with average net LAF injection at Rs 1.14 lakh crore. However, this has moderated in Oct'23 so far to Rs 0.4 lakh crore. However, the skewed distribution of liquidity at the overall banking level with the deployment of large surplus funds under the SDF and simultaneous recourse to the MSF has been one of the concerns raised by the RBI governor. Looking ahead, increased demand for currency in circulation amidst the festive season will counterbalance the increase in liquidity release owing to discontinuation of I-CRR. However, the continuous increase in UPI transactions (small ticket) could act as counterbalancing factor to such a trend. It may be noted that last year currency in circulation declined during the Diwali week for the first time in 20 years. Meanwhile, RBI has highlighted that they may conduct open market operations sales to ensure financial stability while providing liquidity to meet the productive requirements of the economy.

As the demand for liquidity has turned more on-tap given a 24/7 payment system while supply of liquidity is a constellation of several autonomous factors including the government surplus cash balance and foreign flows (inclusion in JP Morgan Index) RBI has to delicately manage the liquidity. We believe that the RBI's preference of OMO sales as a preferred option, is to attenuate the build up of any transient liquidity build up in the system given the surfeit of Government cash balances coming back with the Government spending likely to accelerate. The bond market needs to understand this fine dichotomy of transient liquidity and permanent liquidity and hence temper its exuberance. In principle, thus there is an **extension of policy quadrilemma (capital flows, a fixed exchange rate and an independent monetary policy, financial stability) to policy pentilemma with frictional liquidity management** emerging as the overarching objective in influencing the smooth conduct of monetary policy in India.

Various measures initiated on Developmental and Regulatory side continue the reforms pitch unfolding. Revised IRAC and Provisioning norms for projects are likely to smoothen the incremental credit flow to infrastructure where many unconventional players are likely to join the league while extending uniform credit risk transfer norms to Middle and Base line of NBFCs (9361 out of total 9376 NBFCs) could be a confidence building measure, offering a level playing field.

SROs would play an important role in strengthening compliance culture among their members while also providing a consultative platform with the RBI for responsible policy making, promoting ethics and addressing issues like market integrity, data privacy, and cybersecurity, building trust among consumers, investors, and regulators. Enhancing PIDF tenor by two years and including PM-Vishwakarma are proactive approach towards bolstering the nation's digital payments ecosystem / financial inclusion while permitting card-on-file tokenization directly at the bank level, upping the gold loan limit for select better performing UCBs and revamping Internal Ombudsman scheme for the entire sector bode well for consumers, we think.

REPO RATE KEPT AT 6.5%

- As widely expected, MPC decided to keep repo rate at 6.50%. It also decided to remain focused on withdrawal of accommodation to ensure that inflation progressively aligns to the target, while supporting growth, though not unanimously. One of the members expressed reservations on withdrawal of accommodation.
- RBI retained its inflation projection for FY24 at 5.40% with Q2 at 6.4% (earlier: 6.2%), Q3 at 5.6% (earlier: 5.7%), and Q4 at 5.2% (earlier: 5.2%). A slight downward revision for Q3 projection is on the back of vegetable price correction and the recent reduction in LPG prices. The future trajectory will be conditioned by a number of factors like lower area sown under pulses, dip in reservoir levels, El Niño conditions and volatile global energy and food prices. We believe that the inflation is less likely to breach the 6% mark in coming months and will remain range bound (5-6%).
- RBI has retained its real GDP projection at 6.50% for FY24 with Q2 at 6.5%, Q3 at 6.0% and Q4 at 5.7%. All estimates are same as provided in last policy. Domestic macro conditions are expected to benefit from the sustained buoyancy in services, revival in rural & urban demand (due to upcoming festive season), consumer and business optimism, the government's thrust on capex, and healthy balance sheets of banks and corporates. However, headwinds from global factors like geopolitical tensions, volatile financial markets and energy prices, and climate shocks pose risks to the domestic growth outlook.

LIQUIDITY MANAGEMENT

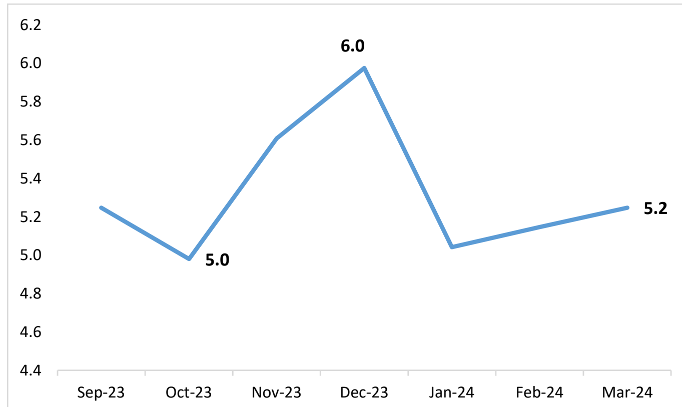
- Liquidity turned into deficit mode in second half of September owing to increase in Government surplus cash balances following advance tax and GST outflows, with average net LAF injection at Rs 1.14 lakh crore. However, this has moderated in Oct'23 so far to Rs 0.4 lakh crore. However, the skewed distribution of liquidity at the overall banking level with the deployment of large surplus funds under the SDF and simultaneous recourse to the MSF has been one of the concerns raised by the RBI governor.
- Looking ahead, increased demand for currency in circulation amidst the festive season will counterbalance the increase in liquidity released owing to discontinuation of I-CRR, though continuous increase in UPI transactions could act as counterbalancing factor to such a trend.
- Meanwhile, RBI has highlighted that they may conduct open market operations sales to ensure financial stability while providing liquidity to meet the productive requirements of the economy.

RBI Growth & Inflation Outlook for India

CPI Inflation (%)	Q2 FY24	Q3 FY24	Q4 FY24	FY24	Q1 FY25
Oct'23	6.4	5.6	5.2	5.4	5.2
Aug'23	6.2	5.7	5.2	5.4	5.2
Jun'23	5.2	5.4	5.2	5.1	-
Real GDP Growth (%)	**Q2 FY24**	**Q3 FY24**	**Q4 FY24**	**FY24**	**Q1 FY25**
Oct'23	6.5	6.0	5.7	6.5	6.6
Aug'23	6.5	6.0	5.7	6.5	6.6
Jun'23	6.5	6.0	5.7	6.5	-

Source:RBI, SBI Research

CPI Inflation Trajectory (%)



Source: SBI Research; SBI Projections

Liquidity Position (Rs lakh crore)

	1-Apr-23	Average in FYTD24	5-Oct-23
Repo Outstanding	0.54	0.11	0.09
Reverse Repo Total	0.00	0.47	0.06
SDF statrted on 08.04.2022	2.88	1.02	0.56
MSF	0.01	0.27	0.81
Standing Liquidity Facility Availed from RBI	0.20	0.05	0.03
SLTRO for Small Finance Banks	0.03	0.03	0.03
Net LAF (-absorption)	-2.10	-0.95	0.34
Excess Reserve	0.06	0.02	0.05
System Liquidity (-absorption)	-2.17	-0.97	0.29
Government Cash Balance	-0.96	1.43	2.65
Core Liquidity (-Surplus)	-1.21	-2.41	-2.36

Source: RBI, SBI Research

- As the demand for liquidity has turned more on-tap given a 24/7 payment system while supply of liquidity is a constellation of several autonomous factors including the government surplus cash balance and foreign flows (inclusion in JP Morgan Index) RBI has to delicately manage the liquidity.
- We believe that the RBI option of OMO sales as a preferred option, is to attenuate the build up of any transient liquidity build up in the system given the surfeit of Government cash balances coming back with the Government spending likely to accelerate. The bond market needs to understand this fine dichotomy of transient liquidity and permanent liquidity and hence temper its exuberance.
- In principle, thus there is an extension of policy quadrilemma (capital flows, a fixed exchange rate and an independent monetary policy, financial stability) to policy pentilemma with frictional liquidity management emerging as the overarching objective in influencing the smooth conduct of monetary policy in India.

DEVELOPMENTAL AND REGULATORY MEASURES

- ***Prudential Framework for IRAC and Provisioning pertaining to Advances - PUI***: Given huge infrastructure needs emanating from diverse sectors, existing as also sunrise ones, smoothening the IRAC and provisioning norms for REs should strengthen funds flow from various entities as more unconventional players are joining the league.
- ***Credit Concentration Norms – Credit Risk Transfer***: RBI in its guidelines dated 19th April 2022, on Large Exposure Framework for Non-Banking Financial Company - Upper Layer (NBFC-UL) permits exposures to the original counterparty to be offset with certain credit risk transfer instruments such as Cash margin/ caution money/security deposit against which right to set off is available, held as collateral against the advances, Central Government guaranteed claims which attract 0% risk weight for capital computation, State Government guaranteed claims which attract 20% risk weight for capital computation; corporate bonds held in current category and hedged by Credit Default Swap (CDS) etc. However, the same guidelines were explicitly for NBFC-UL only.
- Now, with a view to harmonize the aforesaid norms among NBFCs in the Middle Layer (ML) and Base Layer (BL), RBI has decided to permit NBFCs in the ML and BL as well, to offset their exposures with eligible credit risk transfer instruments.
- This is a welcome step for the sector and provide level playing fields across NBFCs. It is pertinent to mention that out of total 9376 NBFCs registered with RBI, only 15 are classified as NBFC -UL others are classified as Middle and Base layer.
- ***Framework for recognition of SROs for Regulated Entities (REs) of RBI:*** SROs can play an important role in strengthening compliance culture among their members and also provide a consultative platform with the RBI for policy making. So, RBI's proposed draft omnibus framework for recognizing SROs for various categories of REs for stakeholder comment as SROs promote responsible practices and ethics in fintech to prevent unethical behaviors like excessive interest rates and borrower harassment while also addressing issues like market integrity, data privacy, and cybersecurity, building trust among consumers, investors, and regulators.
- ***Extension of Payments Infrastructure Development Fund (PIDF) and Inclusion of PM Vishwakarma Scheme beneficiaries***: RBI has proposed to extend the PIDF Scheme by a further period of 2-years, i.e., upto December 31, 2025. Also, it is proposed to include beneficiaries of PM Vishwakarma Scheme in all centres under the PIDF Scheme. Both the steps has demonstrated a proactive approach towards bolstering the nation's digital payments ecosystem, aligning with the ever-evolving needs of the industry as also paving the way for financial inclusion.
- ***Introducing new channels for Card-on-File Tokenisation :*** The proposal to introduce card-on-file tokenization directly at the bank level is a game-changer for both cardholders and the financial industry as a whole. It enhances convenience and security, reducing the friction associated with digital transactions. This forward-looking initiative reflects the RBI's commitment to fostering a robust and secure payments landscape in India.
- ***Limit for gold loans under bullet repayment scheme*** increased from Rs 2 lakh to Rs 4 lakh in respect of UCBs which have met the PSL targets as on 31 Mar'23.
- ***Internal Ombudsman Scheme*** will be further fine-tuned to strengthen the grievance redressal system and safeguard the interest of customers.

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